THE WHITE HOUSE

WASHINGTON

June 14, 1985

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: ROGER B. PORTER RBP

SUBJECT: Agenda and Papers for the June 17 Meeting

The agenda and papers for the June 14 meeting of the Economic Policy Council are attached. The meeting is scheduled for 10:30 a.m. in the Cabinet Room.

The first agenda item is an overview of U.S.-E.C. trade relations. At the June 5 meeting, the Council requested the Department of State and the Office of the U.S. Trade Representative to prepare a strategy paper for U.S.-E.C. trade relations. A copy of that paper was circulated to Council members on June 11.

The second agenda item concerns the Section 301 Citrus case. The President must decide by June 20 on what action, if any, to take in response to the European Community's practice of discriminating against U.S. exports or citrus products. A memorandum on this issue was circulated to Council members on June 3 and discussed at the June 5 meeting.

The third agenda item concerns the status of the President's steel program announced on September 18, 1984. The Office of the U.S. Trade Representative has prepared a paper on the President's Steel Program which reviews the status of steel trade negotiations, the recent pattern of imports, and the options the Administration faces on four specific issues. This paper has not yet been reviewed by other departments and agencies. It lays out the central issues and options for discussion and <u>is not intended to serve as the basis for reaching any decisions at this meeting</u>.

Attachments

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ECONOMIC POLICY COUNCIL

June 17, 1985

10:30 a.m.

Cabinet Room

AGENDA

1. U.S.-E.C. Trade Relations
2. Citrus Section 301 Petition
3. Status of the President's Steel Program

June 14, 1985

President's Steel Program

Issue: The President's steel program is at a critical juncture. The Administration needs to decide what additional measures, if any, need to be taken to ensure full implementation of the program.

This paper reviews the status of steel trade negotiations the U.S. Trade Representative has held, the recent pattern of imports, and the options the Administration faces on four specific issues:

1. The substantial increase in imports of "consultation products" from the European Community (EC);

2. The greater-than-expected shipments from Canada;

3. Surges from new suppliers that have not previously been significant exporters to the U.S.;

4. Complaints about the adequacy of the semifinished steel target.

Status and Effects of Negotiations

Since September 18, 1984, the U.S. Trade Representative has held negotiations with 16 countries aimed at concluding voluntary restraint agreements. (Table 1 summarizes the status of these negotiations as of June 13, 1985.) Thus far, the U.S. has reached agreements with 14 countries, of which 12 have been formally signed and implemented.

These agreements cover about 58 percent of total imports and, everything else being equal, will reduce the 1984 finished steel import level from 26 percent by about 4.6 percentage points. The EC steel arrangements cover another 22 percent of total imports. With the negotiation of strengthened provisions on pipe and tube imports, total imports from the EC should fall by about 0.7 percentage points to about 5.2 percent. It should be noted that the 100,000 ton exception for EC line pipe recently provided for the All American Pipe Line will increase imports by about 0.1 percentage points. Thus, all of the agreements should reduce imports by a maximum of about 5.3 percentage points and would likely reduce them by about 5.1-5.2 points. Such a reduction would result in imports still being about 2 percentage points above the 18.5 percent target.

The agreements are gradually having an effect on imports as shown by the following table:

	Imports as a Percentage of Apparent Consumption	
	Including Semifinished	Excluding Semifinished
1984 - Year	26.6	25.8
1984 - Fourth quarter	28.5	27.2
1985 - January	30.9	29.6
February	27.1	26.0
March	24.5	24.1
April	23.0	n.a.

As a number of suppliers -- including Japan -- reduce exports to compensate for overshipments in the October-March period, import penetration should fall even further.

Surge of Imports

Despite the effectiveness of the agreements in reducing imports, these reductions have been partially offset by surges of imports from three major sources:

- European Community. Imports of unlicensed "consultation products" in 1984 were 224 percent above the 1981 benchmark and further increases have occurred this year (see Table 2). This increase has added about 0.4-0.5 percentage points to the finished steel import level. The decision to aim for an 18.5 percent target assumed a 4.9 percent share for the EC. The pipe and tube arrangement would reduce the 1984 5.9 percent level to about 5.2 percent.

- Canada. The decision not to seek a voluntary restraint agreement from Canada resulted from a combination of two factors: (1) its steel producers are not very vulnerable to antidumping and countervailing duty charges; and (2) as an exporter of numerous small overland shipments, it would be uniquely affected by any formal restraint agreement. (As the program has evolved, the licensing requirement would minimize the Customs clearance problems that concerned the Canadians.) Despite several assurances that Canada will not exploit the restraints of others, Canadian shipments continue at the 2.9-3.2 percent level, well above the historical level or the 2.4 percent level originally assumed in the program.

- New Suppliers. There has been an explosion of new suppliers to the U.S. market in recent years, including unlikely suppliers like Thailand, Algeria, Portugal, and Zimbabwe. In some cases, the rate of increase has been dramatic with countries reaching a significant market share in a limited number of products in just one or two years. (Table 3

summarizes some of the most dramatic examples.) The program originally assumed no or insignificant imports from new suppliers, which now account for approximately 2-2½ percent of domestic consumption.

Policy Options

Issue 1: Europe: How should the Administration address the substantial increase in imports of "consultation products" from the EC?

Secretary Baldrige has succeeded in establishing a framework for negotiation of a comprehensive solution to our steel trade dispute with the EC. The framework comprises three major elements:

1. Negotiation by July 15 of a solution to the dispute over the "consultation products" that were not specifically limited by the 1982 Arrangement.

2. Agreement by October 31 on extending the scope and duration of the Arrangement (which expires December 31, 1985) to make it consistent with the other voluntary restraint agreements under the program.

3. Immediate release of 100,000 tons of line pipe to permit the uninterrupted construction of the All American Pipe Line.

The Administration clearly prefers a negotiated settlement to a confrontation over the consultation products. However, the Administration should consider now what action, if any, to take if the U.S. and EC cannot agree by July 15 on a solution to the dispute over the consultation products. There are strong indications that a badly fragmented EC industry will stoutly resist Commission efforts to implement the burden-sharing required by any solution. Hence, the Administration may well face the decision of what action to take after July 15.

Option A: Communicate during the negotiations that if an agreement is not reached by July 15, the Administration will unilaterally enforce the provision on consultation products in the 1982 Arrangement.

Advantages

- Communicating a decision to take unilateral action as a last resort would bolster the Administration's position in the current negotiations.

- This approach increases the prospects for success in the current negotiations, which in turn would make it more likely that the Administration will reach the 18.5 percent target. Without a reduction in the consultation product imports from their 1984 level, which was twice the 1981 benchmark for finished products and seven times the 1981 benchmark for semifinished products, it is difficult to see how the 18.5 percent target can even be approximated.

- The prospect that the Administration would take unilateral action if an agreement is not reached by July 15 increases the likelihood that the EC Commission would explore a quasi-negotiated settlement based on a U.S. unilateral action to which the EC could acquiesce.

<u>Disadvantage</u>

- The EC has threatened to retaliate if the U.S. takes unilateral action. However, it may acquiesce to the action if the U.S. action were sufficiently limited.

<u>Option B</u>: <u>Decide now that if an agreement is not reached by July 15, the Administration will fold the issue into the broader renegotiation of the Arrangement</u>.

<u>Advantages</u>

- This approach would avoid confrontation with EC at a time when there are numerous other contentious issues on the agenda (e.g., agricultural exports).

- The EC would not retaliate against the U.S.

<u>Disadvantages</u>

- Avoiding any action now would seriously jeopardize the Administration's credibility in negotiations across a wide range of issues since we have already conceded to allowing the conditional entry of 100,000 tons of line pipe.

- A delay in resolving this problem makes it more likely that imports of these products will continue to surge, making it more difficult for the Administration to come close to meeting the 18.5 percent target.

<u>Issue 2</u>: <u>Canada</u>: <u>How should the Administration address the greater than expected shipments from Canada?</u>

After the EC, Canada is the only source that by itself could disrupt the program. Both the Canadian Government and its steel producers have repeatedly assured the U.S. Government that they want to cooperate, but on several occasions have told the U.S. steel industry that they are not obligated to do anything at all.

The nature of U.S.-Canada trade is complex, with significant tonnage traded between steel producers on both sides of the border. Even accounting for such trade though, Canadian shipments of such products as pipe, wire products, and cold finished bar appear to have increased substantially.

Option A: Seek to negotiate a voluntary restraint agreement with Canada at the 1981-1983 level (2.4 percent) or higher.

Advantages

- This option would treat Canada on the same basis as other major steel exporters to the U.S., including some countries which can also claim to not dump or subsidize exports.

- A formal restraint would be more effective than the status quo in reducing overall imports by as much as 0.8 percentage points.

Disadvantages

- The political fallout from the U.S. pressuring Canada for a voluntary restraint agreement could be considerable.

- Canada would likely object that it should be excluded from the program because its producers trade fairly.

- Canada would argue that a formal restraint presents unique customs clearance problems for small, overland Canadian shipments.

- This restraint could disrupt certain intracompany trade across the border.

- The U.S. will have little leverage to encourage Canada to agree to voluntary restraint because of their relative invulnerability to unfair trade complaints.

Option B: Continue to express concern over the level of current shipments especially in sensitive products and seek to enhance customs cooperation to minimize transshipments and fraudalent practices by third countries.

Advantages

- This option would avoid the political fallout that would result from the U.S. pressuring Canada for a voluntary restraint agreement.
- This option avoids substantially complicating trade between steel producers across the U.S.-Canadian border.

Disadvantages

- This option is unlikely to reduce Canadian steel imports significantly.
- Continuing to exempt Canada from the program maintains resentment by other "fair traders" which have had to sign formal restraint agreements.

Issue 3: New Suppliers: How should the Administration address the surge in imports from new suppliers?

Certain domestic steel brokers have sought to stay one step ahead of the program by finding new suppliers as other suppliers cut back their exports. It is difficult to control the inflow of a new supplier because our negotiating leverage over it is visible only after it has exported a significant quantity of dumped or subsidized steel. An importer is able to attract new suppliers by moving large quantities of steel rapidly into the market, with the expectation that the worst outcome would be a voluntary restraint agreement guaranteeing the exporter a market share it never had before.

The result may be that for the forseeable future, the Administration will have to pursue new suppliers one by one using recently filed cases as leverage. Ultimately, there will have to be many agreements, instead of the few initially expected. Moreover, these new suppliers can force the Administration to retreat from the overall 18.5 percent target because the market share guaranteed by each new agreement must be added to the market share already guaranteed to suppliers under the original program.

Option A: While imports from new suppliers are at relatively low levels, aggressively pressure new suppliers to agree to restrain shipments and/or self-initiate unfair trade actions against them (including Section 301 petitions).

Advantages

- Only by addressing the imports from new suppliers at low levels can the Administration hope to come close to the 18.5 percent target.
- Some steel producers, led by Bethlehem, prefer this approach in which surges could be controlled before they rise to high levels.

Disadvantages

- It may be difficult to persuade new suppliers to agree to restrain shipments at the current levels at which they are exporting to the U.S.
- Some steel producers, particularly wire rod producers, generally oppose further voluntary restraint agreements, preferring remedies under the unfair trade statutes. These producers believe they are cost competitive with any producer and have been pressured to drop their current cases (20 or more) as part of the agreements reached to date.

  In most of these rod cases, remedy under an unfair trade statute would have severely curtailed imports. In the case of Argentina, this remedy has totally eliminated its rod exports to the U.S. for an entire year.

Option B: Continue to rely on the leverage generated by domestic industry unfair trade cases and wait for foreign governments to request negotiations to settle them.

Advantages

- Given the likely reluctance of new suppliers to agree to restrain shipments, this may be the only realistic approach.
- This approach focuses the Administration's response to this surge in imports on unfairly traded steel.

Disadvantages

- This approach is likely to result in eventually negotiating voluntary restraint agreements with new suppliers only after they have attained a significant market share, with dozens of restraint agreements and total imports significantly above the 18.5 percent target.

- This approach runs the risk that otherwise acceptable agreements with foreign countries could be blocked by some domestic producers refusing to withdraw their unfair trade cases.

Issue 4: Semifinished Steel: How should the Administration address the apparent inadequacy of the semifinished steel target?

At the insistence of the major integrated producers, the Administration agreed to a target of 1.7 million tons of semifinished steel: ingots, billets, blooms, and slabs, all of which are subsequently rolled into intermediate or final shapes. While that target would represent a record level of imports, it is viewed by some producers as inadequate given the needs of the industry over the next 5 years.

Estimates of demand for semifinished imports run as high as 5 million tons with the next 2-3 years. Reports suggest that if semifinished imports are limited to the 1.7 million ton target, a number of domestic producers will be forced to curtail operations they otherwise would have had running.

Semifinished steel is imported for several reasons:

- For competitive reasons, no producer wants to rely for its raw material supply on a direct domestic competitor.

- Continuously cast slabs and certain types of billets will not be readily available in the U.S. until considerable additional investment has taken place.

- Where steelmaking and finishing facilities are not balanced, semifinished imports permit the fuller utilization of rolling mills, helping to drive down unit costs.

- During start-up or modernization, individual mills need external sources of semifinished steel to stay in business.

A number of U.S. producers are heavily dependent on imported semifinished steel, for example, California Steel, Tuscaloosa Steel, Cyclops, and Raritan River. Other producers, including Bethlehem and LTV, import at least some semifinished steel and are reported as having approached Brazilian, Venezuelan, and EC producers for more. Even U.S. Steel is reported to have discussed importing semifinished steel from South Korea.

Some observers may find hypocritical the pressures by integrated producers to keep the 1.7 million ton semifinished target while importing such products themselves. When pressed, senior management of integrated producers will declare that they would cease all semifinished imports if necessary, although their purchasing managers continue to explore the possibility of increasing imports.

Thus far, USTR has allocated about 1.5 million tons to the countries with voluntary restraint agreements. Imports from the EC (666,000 tons annual rate) and Sweden (300,000 tons annual rate) continue to be strong. But imports from Canada, the only other unrestrained foreign supplier, have declined sharply to about 70,000 tons per year. However, without a sharp reduction in the EC level of at least 50 percent, it will in all likelihood not be possible to keep close to the target of 1.7 million tons.

Option A: Attempt to maintain the 1.7 million ton target through a combination of voluntary restraint agreements and the filing of unfair trade cases.

Advantages

- Maintains commitment the Administration made to industry leaders in September.
- Such a restriction would help producers (e.g., Bethlehem) investing in new steelmaking equipment.

Disadvantages

- Such a restriction would severely curtail operations of smaller producers who want to increase finished steel production with the aid of semifinished imports.
- Maintaining this target would make it harder to reach agreement with the EC given the rate at which it has thus far exported semifinished steel to the U.S.
- It would also pose a problem for Brazil whose minimum contractual commitments already exceed the 700,000 ton limit agreed to in December.

- This limit places the U.S. Government in the awkward position of having to allocate semifinished imports among domestic companies and thus determining which particular firm will be able to operate at desired levels.

Option B: Raise the limits negotiated to a level closer to predicted peaks.

Advantages

- Such an increase in limits would enable some domestic producers to continue to produce finished steel.
- An increase in the semifinished target would provide the Administration additional leverage with countries wishing to export finished steel to the U.S.

Disadvantages

- Some integrated producers may object that the Administration has reneged on its commitment to the 1.7 million ton target.

Option C: Impose a tariff on all semifinished imports.

Advantages

- Although the price of semifinished imports would be higher than it otherwise would be, domestic producers would at least be able to import any quantity they need to meet demand.
- A tariff system would obviate the need for the U.S. Government to allocate shares of semifinished imports among domestic companies.

Disadvantages

- Some integrated producers would likely object that the Administration has reneged on its commitment to the 1.7 million ton target.
- If the tariff is not at a high enough level, large semifinished imports would jeopardize the modernization efforts of a number of integrated producers.

Option D: Impose a tariff-rate quota on all semifinished imports, with tariff-free quantities based on the voluntary restraint agreements already negotiated and on historical levels for other suppliers (principally Canada, Sweden, and the EC).

Option D would have the same advantages and disadvantages as Option C except the following.

Advantages

- A tariff-rate quota would permit importers to enjoy some benefit from the limits they have already negotiated.

Disadvantages

- Unlike a simple tariff, the Administration would be forced to take action against specific countries, in particular Canada and Sweden, which have thus far expressed no interest in negotiating voluntary restraint agreements.

TABLE 1

STATUS OF VRA TALKS

	Implemented	Pending Signature	Under Negotiation	Import 1984	Penetration VRA
Japan	X			7.05	5.80
Korea	X			2.48	1.90
Brazil	X			1.42	.80
Spain	X			1.45	.67
S. Africa	X			.59	.42
Mexico	X			.83	.36
Finland	X			.30	.22
Venezuela	X			.51	.20
Australia	X			.20	.18
Romania	X			.28	.16
E. Germany		X		.29	.11-12
Poland		X		.14	.10
Czechoslovakia	X			.07	.04
Hungary	X			.04	.04
Austria			X	.34	--
Argentina			X	.31	--

TABLE 2

IMPORTS OF CONSULTATION PRODUCTS FROM THE EUROPEAN COMMUNITY (000 OF NET TONS)

	Benchmark (1981)	1984	1985*
Finished	331	632	888
Semifinished	112	809	848
TOTAL	443	1,441	1,736

* Three months, annualized.

TABLE 3

ILLUSTRATIVE SURGES FROM NEW SUPPLIERS
(000'S OF TONS)

	1983	1984	1985 (annualized)
Romania**	9	272	693
Sweden	214	639	615
Venezuela**	154	491	562
Austria*	35	326	498
E.Germany**	13	274	296
Taiwan	177	160	234
Portugal	0	55	135
Norway	2	61	81
Trinidad-Tobago	66	67	75
Israel	2	9	31
India	8	10	20
Chile	0	8	15
Singapore	0	1	14
Thailand	0	0	4
TOTAL	680	2,373	3,273
% CHANGE	---	+249	+38

* Negotiations under way
** Restraint agreement concluded